

Size Standards and Contract Bundling in the Federal Marketplace: An Uphill Battle for Small Business Owners

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The Small Business Act was created to aid, counsel, assist, and protect the interests of small businesses in order to preserve free competitive enterprise. As numerous small business owners have discovered, these protections are not always as effective as they might seem in the realm of federal contracting. Problems have stemmed from loosely enforced size standards, unreliable data tracking systems, and insufficient oversight from various federal agencies, including the Small Business Administration. This article examines the controversy surrounding the government's system for reporting the level of small business participation in the federal contract marketplace and the effects of contract bundling on the number of opportunities available to small business owners. Special attention is given to the reports and investigations that have uncovered many of these problems, as well as a review of the possible solutions that could protect the role of small businesses in the federal contracting.

Small businesses play a significant role in the development of the United States economy. They have been a catalyst for change and invention, as well as being the starting point for many of today's most successful companies. Nonetheless, the success of a small business does not come without significant challenges. In order to prosper, entrepreneurs must often find ways to expand their businesses and enter new markets in the face of considerable risk and expense. These business owners must find a way reach new customers and build continuing relationships. The federal government can be an excellent resource for small businesses facing these challenges. But in order to break into the federal marketplace, it is essential to learn how the protections of the Small Business Act (the "Act")¹ operate. This means not only knowing the rules, but also knowing the true nature of the system and the challenges small businesses face in spite of the system designed to protect them.

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¹ Small Business Act, 15 U.S.C. §§ 631-648 (2000).

As small businesses attempt to enter the federal marketplace, they are faced with regulations that allow large businesses to take opportunities designated for small businesses and a fragile system of information reporting that seems to turn a blind eye to the problem. Weakly enforced penalties provide little recourse and have created an environment where growth of small business opportunities for federal contracts has become stagnant. In addition, the problem of contract bundling, one of the most significant barriers to small business access to federal contracts, is consistently treated as a low priority among federal agencies charged with controlling it. These problems present significant challenges to small businesses that can only be addressed by creating a more reliable, efficient system of monitoring and meaningful enforcement of the laws on which small businesses depend.

I. SMALL BUSINESS IN THE U.S. ECONOMY

The small business sector in the U.S. is a driving force for the entire economy. The nation's 23 million small businesses are credited with creating 60% to 80% of all new jobs over the past decade.² They represent 99.7% of all employers in the U.S. and employ more than one half of all private sector employees.³ This substantial workforce also produces over 50% of the nation's Gross Domestic Product. Given these significant statistics, it is obvious that the health of the small business sector is critical to U.S. economic growth. Beyond the economic factors, small businesses give individuals a chance to pursue their interests, create a better life, and create employment for groups that might otherwise be shut out of the labor market.⁴ The protection of this portion of the economy is vital to the U.S. economic system as a whole and the government provides much of this protection through the Act.⁵

II. SMALL BUSINESS IN THE FEDERAL MARKETPLACE

Recognizing the importance of small business concerns, Congress enacted the Act in accordance with its policy that the government should aid, counsel, assist, and protect the interests of small business concerns in order to preserve free competitive enterprise.⁶ Some of the protections called for by the Act include assistance to compete in international markets,

² DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., 109TH CONG., SMALL BUSINESS RECORD 1 (2005).

³ U.S. SMALL BUSINESS ADMIN., OFFICE OF ADVOCACY, A GUIDE FOR GOVERNMENT AGENCIES: HOW TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT 99 (2003).

⁴ U.S. SMALL BUSINESS ADMIN., OFFICE OF ADVOCACY, THE SMALL BUSINESS ECONOMY: A REPORT TO THE PRESIDENT 5 (2005).

⁵ Small Business Act, 15 U.S.C. §§ 631-648 (2000).

⁶ *Id.* § 631(a).

financial assistance for agricultural-related industries, aid to historically underutilized business zones, assistance to victims of natural disasters, full participation of minorities and economically disadvantaged persons in the economy, and specific provisions to aid women-owned businesses.⁷ Additionally, because Congress recognized the direct impact that the government can have on the vitality of small businesses, the Act requires that a fair proportion of total purchases and contracts for property and services for the government be placed with small business enterprises.⁸

In order to ensure that a fair portion of all government contracts be placed with small business concerns, the Act requires that each federal agency, to the maximum extent practicable, must: (1) comply with congressional intent to foster participation of small business concerns as prime contractors, subcontractors, and suppliers; (2) structure its contracting requirements to facilitate competition by and among small business concerns, taking all reasonable steps to eliminate obstacles to their participation; and (3) avoid unnecessary and unjustified bundling of contract requirements that precludes small business participation in procurements as prime contractors.⁹ While these may seem like relatively simple requirements to implement, they become more imposing tasks when considering the scope of federal spending and the number of federal agencies affected. In 2004, a record was set with purchases approaching \$300 billion, up 3.4% from 2003¹⁰ and continuing a trend of growth. In its latest Small Business Goaling Report, the Small Business Administration (SBA) reports the contracting results of seventy government agencies.¹¹ As a result of its massive size, the federal government's purchasing also provides enormous potential for small businesses to grow when doing work in the federal marketplace if small business interests are properly protected. Yet, the protections that are provided for small businesses do not necessarily work as they are designed in all respects. Numerous studies and government reports have revealed major weaknesses in the government's methods for reporting and measuring small business participation as well as insufficient safeguards against one of the foremost obstacles facing small businesses in the federal marketplace: contract bundling.

⁷ See *id.* § 631.

⁸ *Id.* § 631(a).

⁹ *Id.* § 631(j).

¹⁰ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., 109TH CONG., SCORECARD VI 7 (2005), available at <http://www.house.gov/smbiz/democrats/Reports/scorecardVI.pdf>.

¹¹ SMALL BUSINESS ADMIN., SMALL BUSINESS GOALING REPORT (2005), available at <http://www.sba.gov/GC/goals/Goaling-Report-08-21-2005.pdf>.

A. *Defining Small Business*

In order to determine which businesses would qualify for the protections of the Act, federal agencies must rely on the guidelines established by the SBA. These determinations are made on an industry-by-industry basis according to North American Industry Classification System codes and are based on either the maximum annual receipts of a business¹² or a maximum number of employees¹³ according to the industry specification.¹⁴ Unless specifically authorized by statute, no federal agency may prescribe its own size standards for categorizing small business concerns.¹⁵ In order to keep the size standards that are based on annual receipts at a level that accurately reflects which businesses are considered small, the SBA is required to examine inflation's impact on the standards at least once every five years. If the SBA determines that inflation has significantly eroded the value of the standards, it must adjust them upwards.¹⁶ This not only provides a safeguard for small businesses that are at risk of losing their small status due to price level increases (rather than increased business activity), but it also allows federal agencies greater flexibility in awarding contracts to small business concerns.

The SBA most recently adjusted its size standards in December of 2005.¹⁷ Since the last adjustment of the standards in February 2002, the general level of prices had increased by 8.7%.¹⁸ Based on the SBA's estimates, this adjustment would allow approximately 12,000 businesses to regain small business status¹⁹ and could lead to up to \$400 million in federal contract awards for these newly-designated businesses.²⁰ While these changes should have a positive impact on small businesses in general, there are ongoing concerns with the system of determining small business status as a whole.

B. *Size Certification*

When a federal agency awards a contract, it is not responsible for determining the size status of the business receiving that contract. Also disconcerting is the fact that an individual business receiving a contract is not required to obtain any official determination that it is in fact a small

¹² See Small Business Size Regulations, 13 C.F.R. § 121.104 (2005).

¹³ See *id.* § 121.106.

¹⁴ *Id.* § 121.201.

¹⁵ 15 U.S.C. § 632(a)(2)(C) (2000).

¹⁶ 13 C.F.R. § 121.102(c) (2005). See also Small Business Size Standards, 70 Fed. Reg. 72,577 (Dec. 6, 2005).

¹⁷ Small Business Size Standards, 70 Fed. Reg. 72,577 (Dec. 6, 2005).

¹⁸ *Id.* at 72,582 (reporting previous inflation adjustments ranged between 16% and 100%).

¹⁹ *Id.* at 72,578 (Dec. 6, 2005).

²⁰ *Id.* at 72,581.

business. Instead, the business must self-certify that it is small under the size standard specified in the particular agency's solicitation.²¹ The contracting agency may then accept the business's self-certification as true in the absence of a written protest by other offerors or some other credible reason to question the truthfulness of the certification.²² Thus, the SBA relies on other bidders who are legitimate small businesses to expose those firms that are large and may be unqualified to bid on a particular contract. While this system may be more efficient than requiring businesses to obtain certification of their size status, it is also a system that is open to abuse.

The Act does prescribe penalties for parties who misrepresent any concern or individual as a small business concern, including a fine of up to \$500,000, imprisonment for up to ten years, or both.²³ Violators will also be ineligible for participation in any program conducted under the Act for up to three years.²⁴ On their face, these stern penalties would seem to be effective deterrents for any potential misrepresentation. Unfortunately, this has not been the case. In Fiscal Year ("FY") 2002, the SBA processed 383 size protests, 110 of which were dismissed on procedural grounds.²⁵ Of the cases accepted for review, eighty-five firms were found to be "other than small."²⁶ The problem lies in the infrequency with which penalties for misrepresentations are handed down. According to the SBA's Administrator for Size Standards, Gary Jackson, only about "a dozen" companies have been penalized in the last twenty years.²⁷ This atmosphere of soft enforcement of misrepresentation penalties does little to dissuade potential violators.

Dependency on the self-certification system combined with the infrequency of penalization and additional regulations governing the reporting of a particular business concern as "small" has created an environment where it is far too easy for large businesses to be categorized as small businesses. This creates the problem of miscoding, which occurs when a contract is misrepresented as a small business contract and is actually performed by a large business. The problem has become widespread, with thirty-one federal agencies having known instances of miscoding.²⁸ A 2004 report issued for the SBA's Office of Advocacy²⁹ stated that in fiscal year 2002 alone, miscoding led to overstatement of

²¹ 13 C.F.R. § 121.405 (2005).

²² *Id.*

²³ 15 U.S.C. § 645(d)(2) (2000).

²⁴ *Id.*

²⁵ EAGLE EYE PUBLISHERS, INC., ANALYSIS OF TYPE OF BUSINESS CODING FOR THE TOP 1,000 CONTRACTORS RECEIVING SMALL BUSINESS AWARDS IN FY 2002 2 (2004), available at <http://www.sba.gov/advo/research/rs246tot.pdf>.

²⁶ *Id.*

²⁷ Jim Wyss, *Giant Firms Get 'Small Business' Benefits*, MIAMI HERALD, Dec. 30, 2005, at 22A.

²⁸ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., *supra* note 10, at 5.

²⁹ EAGLE EYE PUBLISHERS, INC., *supra* note 25, at 1.

small business participation in the federal marketplace by more than \$2 billion dollars.³⁰ Among the top 1,000 contractors receiving small business awards for that year, thirty-nine were found to be “large” companies and another five were actually non-profit organizations and government entities.³¹ This not only directly impacts small businesses by taking federal contracting opportunities away from them, but it also reduces agency accountability for meeting the required goals of small business inclusion.

C. Meeting the Goals

The Act requires that the government maintain a government-wide goal for participation by small business concerns of at least 23% of the total value of all prime contract awards for the fiscal year.³² The SBA and the Office of Federal Procurement Policy are charged with ensuring that the cumulative annual prime contract goals for all agencies meet or exceed the goal of 23%. The SBA must annually meet with the head of each federal agency to establish goals for small business participation specific to each agency and coordinate these individual goals to meet the government-wide requirement.³³ At the end of each fiscal year, each agency must report to the SBA on the extent of participation by small business concerns and provide justifications for any failure to meet the established goals.³⁴ The SBA is then responsible for compiling data and analyzing the individual reports in order to submit its own report to the President and Congress, reflecting the actual performance in attaining the individual and cumulative goals.

There has been debate on whether the government’s record is adequate for meeting this goal in recent years. According to the official statistics derived from the Federal Procurement Data System, the federal government has met its goal for the last two years at 23.1% in FY 2004³⁵ and 23.6% in FY 2003.³⁶ Prior to that, the government fell short of its goal in FY 2002 with 22.6%;³⁷ in FY 2001 with 22.8%;³⁸ and in FY 2000 with 22.3%;³⁹ last reaching its goal in FY 1999 with 23.1%.⁴⁰ Nevertheless,

³⁰ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., *supra* note 10, at 5.

³¹ EAGLE EYE PUBLISHERS, INC., *supra* note 25, at 1.

³² 15 U.S.C. § 644(g)(1) (2000).

³³ *Id.* § 644(g)(2).

³⁴ *Id.* § 644(h).

³⁵ SMALL BUSINESS ADMIN., *supra* note 11.

³⁶ SMALL BUSINESS ADMIN., FY 2003 FINAL PRIME CONTRACT ACHIEVEMENTS 1 (2004), available at http://www.sba.gov/GC/goals/fund2003_prime.pdf.

³⁷ SMALL BUSINESS ADMIN., FINAL FY 2002 PRIME CONTRACT GOALING ACHIEVEMENTS viii (2003), available at <http://www.fpdc.gov/fpdc/FPR2002a.pdf>.

³⁸ SMALL BUSINESS ADMIN., FINAL FY 2001 PRIME CONTRACT GOALING ACHIEVEMENTS viii (2002), available at <http://www.fpdc.gov/fpdc/FPR2001a.pdf>.

³⁹ SMALL BUSINESS ADMIN., FINAL FY 2000 PRIME CONTRACT GOALING ACHIEVEMENTS viii (2001), available at <http://www.fpdc.gov/fpdc/FPR2000a.pdf>.

some of the methods used for reporting this data have been the subject of recent controversy.

One such issue has been in regards to the Federal Procurement Data System (“FPDS”) itself. Fiscal year 2004 was the first year for the new Federal Procurement Data System – Next Generation (“FPDS-NG”). This system was put into place as a result of the concerns that the previous FPDS was plagued with inconsistencies.⁴¹ Problems cited under the previous version of the system resulted from a lack of training for individuals entering the data, high personnel turnover, the complexity of the various agency systems, and frequent changes to the FPDS data entry requirements. The FPDS-NG system was designed to eliminate much of the human error that led to unreliable information. Despite the changes in the new system, such as the elimination of intermediate systems and allowing information to flow directly from agency systems thereby reducing the chances of manipulation of the data, studies indicate that there has been little improvement in the reliability of the information reported. The SBA even included a notice of the potential inaccuracy of this system’s information in the Small Business Goaling Report for FY 2004. The SBA specifically cited potential sources of inaccuracies including the initial data migration from the previous FPDS to the FPDS-NG; current data collection policies and data retrieval requirements; and the original data provided by the agencies.⁴²

A 2005 report, called Scorecard VI, issued by the Democratic Staff of the House Small Business Committee detailed a study which included an evaluation of the accuracy of the new system.⁴³ The study focused on the twenty-two agencies that comprise approximately 99.6% of the total dollar amount of federal contracts according to FPDS data.⁴⁴ In order to obtain the most accurate information, data for the study was gathered directly from the federal agencies’ internal procurement systems. The results indicated that the FPDS-NG is still unreliable for accurate information. Of the twenty-two agencies evaluated in the study, eighteen of them provided different data than reported in the database.⁴⁵ Further evidence of the system’s problems are apparent when considering that of the 110 elements

⁴⁰ SMALL BUSINESS ADMIN., FINAL PROCUREMENT PREFERENCE GOALING ACHIEVEMENTS FOR FISCAL YEAR 1999 1 (2000), *available at* <http://www.sba.gov/GC/goals/FY99Cover.pdf>.

⁴¹ Letter from William T. Woods, Director, Acquisition and Sourcing Management, U.S. General Accounting Office, to Joshua B. Bolten, Director, Office of Management and Budget (Dec. 30, 2003), *available at* <http://www.gao.gov/new.items/d04295r.pdf>.

⁴² SMALL BUSINESS ADMIN., SUPPLEMENTAL INFORMATION 1, *available at* <http://www.sba.gov/GC/goals/fy04-Supplemental-Info.pdf>.

⁴³ *See also* American Small Business League, New SBA Small Business Numbers Include Billions to Corporate Giants, Aug. 26, 2005, *available at* <http://www.asbl.com/showmedia.php?id=106>.

⁴⁴ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., *supra* note 10, at 13.

⁴⁵ *Id.* at 5.

evaluated in the Scorecard report, fewer than five elements were identical to the FPDS data.⁴⁶ One glaring discrepancy was the \$17 billion overstatement in procurement dollars that the FPDS reported compared to the figure the Department of Defense reported for itself in FY 2004.⁴⁷ When aggregated, these discrepancies can lead to a considerably different result if used to calculate the federal government's efforts to reach its goal of 23%.

The results of this study indicate that the federal government fell short of its goal in FY 2004 with only 22.44%⁴⁸ of prime contracts going to small business concerns, compared to the 23.1%⁴⁹ calculated using the FPDS data. This discrepancy becomes more notable when translated into monetary terms. Failing to meet the government-wide goal by only 0.56% would cost small businesses \$1.65 billion dollars in lost federal contracting opportunities.⁵⁰ A similar inconsistency was calculated in the previous fiscal year, when the study first began comparing data taken directly from agencies with that collected from the FPDS. Scorecard V indicated that the government only reached 22.68% in FY 2003,⁵¹ compared to the 23.6% officially reported.⁵² This shortfall would indicate approximately \$1 billion in lost contracting opportunities for small businesses in FY 2003.⁵³ By taking these calculations into account, it is possible the federal government has not met its 23% goal since 1999. While the fact that the government may not be meeting the goals set by the SBA is reason for concern by itself, it also raises questions about the accountability of the individual agencies charged with the task of including small business concerns.

As part of the reporting requirements of the Act, the SBA, as well as any agency failing to achieve its goal for the year, must provide analysis of the failed efforts.⁵⁴ Additionally, the individual agencies must provide details of the actions planned by such agency (and approved by the SBA) to achieve the goals in the succeeding fiscal year.⁵⁵ In theory, these requirements would force agencies to analyze and reform their contracting practices, in order to ensure greater small business participation, any time agencies fail to meet their goals. By depending on inaccurate information provided by the FPDS, however, the government has created a system that impedes the progress of small businesses in the federal marketplace. For

⁴⁶ *Id.* at 8.

⁴⁷ *Id.*

⁴⁸ *Id.* at 11.

⁴⁹ SMALL BUSINESS ADMIN., *supra* note 11.

⁵⁰ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., *supra* note 10, at 11.

⁵¹ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., 108TH CONG., SCORECARD V 16 (2004), available at <http://www.house.gov/smbiz/democrats/ScoreCard-VFINAL.pdf>.

⁵² SMALL BUSINESS ADMIN., *supra* note 36.

⁵³ DEMOCRATIC STAFF OF H. SMALL BUSINESS COMM., *supra* note 51, at 16.

⁵⁴ 15 U.S.C. § 644(h)(2) (2000).

⁵⁵ *Id.*

example, if the data from Scorecard VI is more accurate than the FPDS data and the federal government has actually failed to achieve its goal, the SBA and the individual agencies have not been held accountable for this failure. This indicates a trend in which agencies have done little in the past two years to ensure greater participation of small business concerns in their procurement process. If federal agencies are allowed to fall short of the mandated goals without analyzing their contracting practices to improve small business participation, any progress that small businesses have made into the federal marketplace will be substantially impaired.

Further questions are raised with regard to the numerous agencies that are excluded from the annual Small Business Goaling Report. Among the large agencies excluded are the Federal Deposit Insurance Corporation, the Postal Service, the Transportation Security Administration, and the Tennessee Valley Authority.⁵⁶ The reason stated for excluding these agencies is that their contracts are funded predominantly with agency generated resources; however, the policy behind this justification remains unclear. According to the SBA, excluded contracts could add 10% to the approximately \$300 billion worth of prime contracts granted by federal agencies in FY 2004.⁵⁷ Critics of this methodology claim that the exclusions lead to an artificial inflation of the reported percentage of small business contracts, potentially skewing the results by several percentage points.⁵⁸

D. More Size Problems

Another controversial issue is the reporting treatment of small businesses that have grown to the point where they exceed guidelines for classification as a small business. Under SBA regulations, a concern that qualified as a small business at the time it received a contract is considered small throughout the life of that contract.⁵⁹ Even where a small business grows to become a “large” business, the procuring agency may exercise options and still count the award as an award to a small business.⁶⁰ Allowing these large businesses to be continually counted towards an agency’s small business goal makes it increasingly difficult for legitimate small businesses to participate in the federal marketplace and inflates the results reported by the agencies. The problem is also partially due to the

⁵⁶ See SMALL BUSINESS ADMIN., *supra* note 11; FPDS-NG, FPDS-NG Frequently Asked Questions (FAQ), <http://www.fpdsg.com/questions.html> (last visited Feb. 15, 2006).

⁵⁷ David Perera, *Small-biz Report Leaves Gaping Questions*, Sep. 12, 2005, <http://www.fcw.com/article90730-09-12-05-Print>.

⁵⁸ See *id.*

⁵⁹ 13 C.F.R. § 121.404(g) (2005).

⁶⁰ *Id.*

excessive length of some government contracts which can have an active life of up to twenty years.⁶¹

A potential justification for allowing businesses that have grown out of their small business status to be counted is that the natural result of a small business winning government contracts is the opportunity for growth into a larger business. Thus, a small business has benefited from the procurement and should continue to be counted towards an agency's goals. Conversely, once a business should be considered large due to its increased business activity, reporting the procurement as one given to a small business concern no longer furthers the policy behind the SBA. As stated by the Act, its purpose is to aid, counsel, assist, and protect the interests of small-business concerns.⁶² By reporting contracts that are actually being performed by large businesses as small business contracts, legitimate small businesses are actually harmed by being shut out of the federal marketplace.

Additionally, because large businesses are receiving such a high proportion of government contracts reported as small business contracts, legitimate small businesses are being continually forced into the role of a subcontractor.⁶³ As a result, small businesses are left to deal with larger businesses that get the benefits of being the prime contractors. Thus, small businesses do not receive the opportunity to make connections with contracting officers and establish a record of performance with an agency in order to better their chances of receiving prime contracts in the future. While acting as a subcontractor will give small businesses the opportunity to play some role in the federal marketplace, it makes it exceedingly difficult for these businesses to compete for prime contracts and does little to meet the policy concerns set forth in the Act.

E. Proposed Regulations

The SBA has identified the “[f]laws in the procurement process [that] allow large firms to receive small business awards and agencies to receive small business credit for contracts performed by large firms” as its

⁶¹ See SMALL BUSINESS ADMIN., OFFICE OF INSPECTOR GENERAL, REPORT NO. 5-16, REVIEW OF SELECTED SMALL BUSINESS PROCUREMENTS, 2 (2005). However, §125.2 was amended in 2003 to include multiple awards of indefinite-quantity contracts under a single solicitation and orders placed against an indefinite quantity contract under a Federal Supply Schedule Contract, government-wide acquisition contract, or multi-agency contract within the definition of a single contract in an effort to have a greater number of contracts reviewed for potential bundling problems. See 13 C.F.R. § 125.2(d)(1)(iii) (2005).

⁶² 15 U.S.C. § 631(a) (2000).

⁶³ See National Small Business Association, Small Business Access to Federal Contracts, Mar. 10, 2005, <http://nsba.biz/content/778.shtml>.

top challenge in the coming year.⁶⁴ These issues can be addressed in a number of ways. First, the SBA must update its regulations regarding the treatment of multi-year contracts and agencies' ability to receive small business credit after a small business becomes large. The SBA proposed new regulations⁶⁵ addressing these concerns in 2003 but has failed to finalize them. Under the proposed rule, a firm that receives a multiple award contract (including government-wide acquisition contracts and multi-agency contracts) must recertify its size each year for the term of the contract.⁶⁶ Additionally, any interested party would have the ability to file a protest that challenges the size of the concern seeking recertification.⁶⁷ This protest would then trigger a formal size determination by the SBA with respect to the challenged firm. Finalizing these rules would help ensure that large businesses are no longer counted as small businesses for the purpose of meeting the government-wide 23% goal. By requiring recertification and giving legitimate small businesses the opportunity to challenge size certifications in long term contracts, the proposed rule would bring further clarity to the reporting procedures and force agencies to be more accountable for meeting small business participation goals.

The SBA has also recognized that errors by contracting personnel and an over-reliance on FPDS data play a significant role in the difficulties small businesses face in the federal marketplace.⁶⁸ These issues are partially the focus of the Small Business Federal Contractor Safeguard Act of 2005,⁶⁹ which is currently in the hands of the Senate Committee on Small Business and Entrepreneurship. Among the issues addressed in this bill are stricter contract consolidation requirements for military agencies, further reporting requirements for small business participation in prime contracting, additional subcontracting participation requirements, and perhaps most importantly, greater agency accountability.⁷⁰ Specifically, the bill proposes that senior procurement executives at each agency would be required to communicate the importance of achieving small business goals to their subordinates.⁷¹ More importantly, executives would then have the ability to

⁶⁴ SMALL BUSINESS ADMIN., OFFICE OF INSPECTOR GENERAL, REPORT NO. 6-02, FY 2006 REPORT ON THE MOST SERIOUS MANAGEMENT CHALLENGES FACING THE SMALL BUSINESS ADMINISTRATION I (2005).

⁶⁵ Size for Purposes of the Multiple Award Schedule and Other Multiple Award Contracts, 68 Fed. Reg. 20,350 (Apr. 25, 2003).

⁶⁶ Size for Purposes of the Multiple Award Schedule and Other Multiple Award Contracts, 68 Fed. Reg. 20,350, 20,355 (Apr. 25, 2003) (amending 13 C.F.R. § 121.404(c)(1) (2005)).

⁶⁷ *Id.*

⁶⁸ FY 2006 REPORT ON THE MOST SERIOUS MANAGEMENT CHALLENGES FACING THE SMALL BUSINESS ADMINISTRATION, *supra* note 64, at 1.

⁶⁹ Small Business Federal Contractor Safeguard Act of 2005, S. 137, 109th Cong. (2005).

⁷⁰ *See generally id.*

⁷¹ *Id.* § 3.

include the success of such an employee in small business utilization as an annual performance evaluation factor.⁷² By holding agency contractors responsible for meeting their agency's small business participation goals, it is more likely that the 23% goal will be met or exceeded on a regular basis. Consequently, the Small Business Federal Contractor Safeguard Act of 2005 can play an important role in resolving some of the issues faced by small businesses and should be supported strongly.

Finally, in addition to the proposed legislation encouraging small business participation and the more accurate reporting of results, a bill has been introduced that proposes to raise the government goal of 23%.⁷³ The bill, which has been referred to the House Committee on Small Business, would amend Section 15(g)(1) of the Small Business Act⁷⁴ to raise the government-wide goal for participation by small business concerns to not less than 25%.⁷⁵ This bill was introduced in May 2005 and has gained some support, gathering eight cosponsors by the end of the year.⁷⁶ Support for this bill is an important key to furthering the interests of small businesses in the realm of government prime contracting.

III. THE CONTRACT BUNDLING PROBLEM

One major factor keeping small businesses from participating in the government prime contract market is bundling. The problem of contract bundling first became a concern in the early 1990s. Evidence of its negative impact on small businesses was first presented in a 1993 report by the SBA.⁷⁷ The prevalence of contract bundling began to increase further due, at least in part, to the Federal Acquisition Streamlining Act of 1994; this Act encouraged the consolidation of certain contracts.⁷⁸ The reason for the rise of contract bundling was a response to increased demands for a quicker and less complex acquisition process and a reduction in the acquisition workforce at the federal level. The theory behind bundling contracts is that federal agencies can increase efficiency while decreasing administrative costs by taking advantage of volume pricing and consistent upgrades in technology. As a result, agencies began consolidating many of their procurement requirements into mega-contracts that were simply too large to allow small businesses to compete with larger firms. A study

⁷² *Id.* § 3(a)(2).

⁷³ H.R. 2742, 109th Cong. (2005).

⁷⁴ See 15 U.S.C. § 644(g)(1) (2000) for the current version.

⁷⁵ H.R. 2742, 109th Cong. (2005).

⁷⁶ See Legislative Information on H.R. 2742 at Thomas, Library of Congress, available at <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:HR02742:@@P>.

⁷⁷ EAGLE EYE PUBLISHERS, INC., THE IMPACT OF CONTRACT BUNDLING ON SMALL BUSINESS FY 1992 – FY 2001 7 (2002), available at <http://www.sba.gov/advo/research/rs221tot.pdf>.

⁷⁸ DEMOCRATIC STAFF OF HOUSE SMALL BUSINESS COMM., *supra* note 10, at 3.

conducted for the SBA on the impact of contract bundling on small business reveals the true scope of this problem.⁷⁹

Between FY 1992 and FY 2001, federal agencies reporting to the Federal Procurement Data Center issued 1.24 million prime contracts worth a total of \$1.89 trillion.⁸⁰ According to the study, 8.6%⁸¹ of these contracts were bundled; a figure which, taken alone, may not properly demonstrate the severity of the problem. The impact of bundling is more obvious when looking at the total amount of prime contract dollars involved in the practice. The 106,387 bundled contracts (8.6%) that were awarded during this period accounted for \$840.3 billion in government contracts.⁸² By including 44.5% of all reported prime contract dollars over that period in bundled contracts, federal agencies were effectively shutting small businesses out of nearly half of the available federal prime contract market.⁸³ This trend grew throughout the course of the study and contributed to the increasing competitive difficulties faced by small businesses in their attempt to participate in the federal marketplace today. The final results of the study indicated that bundled federal contracts cost small businesses an estimated \$13 billion annually.⁸⁴

A. *What is Contract Bundling?*

The Small Business Act imposes several requirements on federal agencies in an effort to help them comply with the policy of fostering the participation of small businesses in the federal marketplace. One such requirement is that each agency, to the maximum extent practicable, shall “avoid unnecessary and unjustified bundling of contract requirements that precludes small business participation in procurements as prime contractors.”⁸⁵ The Act was updated by its 1997 reauthorization to include a definition of contract bundling. According to the Act:

The term “bundling of contract requirements” means consolidating 2 or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small-business concern due to—
(A) the diversity, size, or specialized nature of the elements of the performance specified;

⁷⁹ EAGLE EYE PUBLISHERS, INC., *supra* note 77.

⁸⁰ *Id.* at 4.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.* at 50.

⁸⁵ 15 U.S.C. § 631(j)(3) (2000).

- (B) the aggregate dollar value of the anticipated award;
- (C) the geographical dispersion of the contract performance sites; or
- (D) any combination of the factors described in subparagraphs (A), (B), and (C).⁸⁶

B. Federal Agency Bundling Requirements

In order to comply with these requirements, federal agencies must contend with a detailed set of procedures when proceeding with an acquisition strategy that could lead to a bundled contract. The general guideline given to the agencies is that, to the maximum extent practicable, their procurement strategies must facilitate maximum participation of small business concerns as prime contractors, subcontractors, and suppliers.⁸⁷ Regarding contract bundling specifically, before proceeding with an acquisition strategy that could lead to a contract containing consolidated procurement requirements, the head of an agency must conduct market research to determine whether consolidation of the requirements is “necessary and justified.”⁸⁸ Despite the guidelines, the matter of determining whether an agency’s potential bundling of contract requirements is necessary and justified can become complex.

In order to be considered necessary and justified, an agency must show that it would derive measurably substantial benefits by consolidating the requirements, as compared to the benefits that it would derive if those requirements are not consolidated.⁸⁹ There are certain benefits which can be included when the agency makes this determination: (1) cost savings and/or price reduction; (2) quality improvements that will save time or improve or enhance performance; (3) reduction in acquisition cycle times; (4) better terms and conditions; and (5) any other benefits.⁹⁰ In order to bring a degree of certainty to deciding what will qualify, there are restrictions on how these potential benefits can be considered, as well as how they are to be determined.⁹¹

Additionally, the reduction of costs alone cannot be a justification for the bundling of contract requirements, “unless the cost savings are expected to be substantial in relation to the dollar value of the procurement requirements to be consolidated.”⁹² Given the open-ended nature of this restriction, the SBA adopted standards to define “measurably substantial benefits.” If a contract’s value is \$75 million or less, the benefits of

⁸⁶ *Id.* § 632(o)(2).

⁸⁷ *Id.* § 644(e)(1).

⁸⁸ *Id.* § 644(e)(2).

⁸⁹ See 13 C.F.R. § 125.2(d)(5)(i) (2005), 15 U.S.C. § 644(e)(2)(B) (2000).

⁹⁰ See 13 C.F.R. § 125.2(d)(5)(i) (2005), 15 U.S.C. § 644(e)(2)(B) (2000).

⁹¹ See 13 C.F.R. § 125.2(d)(5)(iv) (2005).

⁹² 15 U.S.C. § 644(e)(2)(C) (2000).

bundling must be equivalent to 10% of the contract value (including options).⁹³ If a contract's value is greater than \$75 million, the benefits must be equivalent to 5% of the contract value (including options) or \$7.5 million, whichever is greater.⁹⁴ Due to the complex nature of the considerations an agency must make when awarding a potentially bundled contract and the potential for inaccurate reporting of results, careful oversight is essential if the requirements are to be effective in preventing too many improperly bundled contracts. This is especially true in light of the impact that contract bundling has had on small businesses historically. This oversight is the responsibility of the SBA.

The Federal Acquisition Regulation requires contracting officers to notify the SBA when a bundling has been identified.⁹⁵ At this point, an SBA Procurement Center Representative ("PCR") performs a bundling analysis to ensure bundling is warranted and includes reasonable participation for small businesses. When PCRs determine that a bundled requirement is not necessary and justified, they are responsible for recommending alternative procurement methods which would increase small business participation.⁹⁶ Even when PCRs decide bundling is necessary and justified, they still play an important role in ensuring small business involvement by working with the agency to develop a strategy for preserving prime contract participation to the maximum extent practicable.⁹⁷ In spite of these detailed procedures designed to protect small businesses from the effects of contract bundling, a 2005 audit of the contract bundling process by the SBA's Office of Inspector General ("OIG") revealed serious flaws in the system.⁹⁸

C. A Reporting System in Disarray

The OIG's report was conducted to determine whether the SBA ensured that it reviewed all proposed bundled contracts, properly appraised

⁹³ 13 C.F.R. § 125.2(d)(5)(i)(A) (2005).

⁹⁴ *Id.* § 125.2(d)(5)(i)(B).

⁹⁵ 48 C.F.R. § 19.202-1(e)(1)(iii) (2005). According to SBA regulation § 125.2, reporting is also necessary when a proposed acquisition strategy includes goods or services currently being performed by a small business and the magnitude of the quantity or the estimated dollar value of the proposal would render small business participation unlikely (based on the guidelines in 13 C.F.R. § 125.2(b)(2)(i)), or if it seeks to package or consolidate discrete construction projects. 13 C.F.R. § 125.2(b)(3) (2005).

⁹⁶ 13 C.F.R. § 125.2(b)(6)(i) (2005) (including breaking up the procurement into smaller discrete procurements; breaking out one or more discrete components, for which a small business set-aside may be appropriate; and reserving one or more awards for small companies when issuing multiple awards under task order contracts).

⁹⁷ *Id.* § 125.2(b)(6)(ii).

⁹⁸ OFFICE OF INSPECTOR GENERAL, SMALL BUSINESS ADMIN., AUDIT OF THE CONTRACT BUNDLING PROCESS, AUDIT REPORT NO. 5-20, 2 (2005).

whether proposed bundlings were necessary, and complied with the Office of Management and Budget and Government Accountability Office recommendations concerning the bundling process.⁹⁹ The survey, which covered FY 2001 through FY 2004, indicated that the SBA was not reviewing the majority of procurements reported by agencies as bundled.¹⁰⁰ Of the 220 contracts with possible bundlings identified in the survey, 192 (or 87%) were awarded without the SBA's review.¹⁰¹ Based on the minimum dollar reporting requirements, these contracts represented at least \$384 million in potentially lost small business opportunities, if they were in fact bundled contracts.¹⁰² These findings are even more startling considering the fact that the OIG did not review the procurements of nineteen of the twenty-three major procuring agencies, which could mean that a significantly larger number of bundled contracts and contract dollars could have been awarded without proper review by the SBA.

A number of problems were identified within the SBA that contributed to the infrequency of bundling reviews.¹⁰³ Among the most significant problems were the number of PCRs and the lack of proper procedures to analyze potentially bundled contracts. Of the approximately 2,250 federal sites with potential bundling problems, only 250 are provided direct oversight by just 43 PCRs.¹⁰⁴ The SBA has no communication system set up to compensate for their lack of review of the 2,000 sites not covered by PCRs.¹⁰⁵ In FY 2002, these non-reviewed sites awarded approximately \$80 billion in federal prime contracts.¹⁰⁶ The lack of proper oversight has been a significant factor in the SBA's inability to properly review bundlings.

Even at the sites covered by PCRs, there is still a substantial likelihood that potential bundlings can be awarded without review. According to the SBA's Standard Operating Procedures, PCRs are required to establish a written operating plan with the agencies assigned to them as a measure of internal control and to ensure consistency in the reporting of

⁹⁹ *Id.*

¹⁰⁰ The survey reviewed the contracts of the four major procuring agencies for the study including: the Department of Defense, the Department of Health and Human Services, the Department of Transportation, and the Department of Veteran's Affairs. *Id.* at 4.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ Similar problems were identified in 2000 and in 2003 in reports released by the GAO. See GENERAL ACCOUNTING OFFICE, SMALL BUSINESSES: LIMITED INFORMATION AVAILABLE ON CONTRACT BUNDLING'S EXTENT AND EFFECTS 18-21 (2000), available at <http://www.gao.gov/archive/2000/gg00082.pdf>; GENERAL ACCOUNTING OFFICE, SMALL BUSINESS CONTRACTING: CONCERNS ABOUT THE ADMINISTRATION'S PLAN TO ADDRESS CONTRACT BUNDLING ISSUES (2003), available at <http://www.gao.gov/new.items/d03559t.pdf>.

¹⁰⁴ OFFICE OF INSPECTOR GENERAL, SMALL BUSINESS ADMIN., *supra* note 98, at 6.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

possible bundlings.¹⁰⁷ But, of the three PCRs interviewed by the OIG, two did not have operating plans detailing how they would monitor bundling, specific procedures for determining what constitutes a possible bundling, and when proposed procurements should be referred to the SBA for review, while the third did not have a current operating plan.¹⁰⁸ Additionally, representatives from each of the major agencies included in the survey stated that they were not aware of any written operating procedure between them and the PCR responsible for their agency.¹⁰⁹ The lack of control and procedure uncovered by this report exposes a serious problem at a crucial point in the bundling review process. Improvements in the rate at which bundled contract solicitations are reviewed cannot be achieved unless the procedures to pass information from the agencies to the SBA are properly organized. If these poor practices are consistent among the forty-three PCRs and the twenty-three major procuring agencies, the SBA is operating under a system in need of serious attention. Unfortunately, the problems do not end at the initial contact point between the SBA and the contracting agencies.

Once bundling information is relayed to the SBA, it has no internal tracking system to ensure that all possible bundlings are reviewed. Rather, the SBA relies on the FPDS-NG, a system with well known problems regarding the accuracy of its information since its introduction. Without a system to accurately keep track of reported bundlings, the SBA's ability to review bundled contracts in a timely manner is significantly hampered.¹¹⁰ Additionally, the SBA does not have a bundling database as mandated by the Small Business Reauthorization Act of 2000.¹¹¹ The purpose of this database, which was to be established by June 2000, is to document bundled contracts awarded by a federal agency along with each small business that has been displaced as a prime contractor as a result of the award. Despite the Act's mandate, the SBA still does not have such a database and does not have any plans to develop one.¹¹² When considering the fact that there are no statutes granting the SBA power to protest a bundling after a contract has been awarded, the impact that these internal control systems could have on the effectiveness of the SBA's efforts to control contract bundling is undeniable.¹¹³

¹⁰⁷ *Id.* at 10.

¹⁰⁸ *Id.* at 6.

¹⁰⁹ *Id.* at 10.

¹¹⁰ *See id.* at 6 (reporting that a recent bundling notification by an agency could not be located or confirmed by the SBA in a timely manner, and the contract was awarded before the SBA had a chance to review it as a possible bundling; the specific contract could not be looked into due to lost and untracked documentation.).

¹¹¹ Small Business Reauthorization Act of 2000, Pub. L. No. 106-554, § 810 (2000).

¹¹² OFFICE OF INSPECTOR GENERAL, SMALL BUSINESS ADMIN., *supra* note 98, at 8-9.

¹¹³ Alternatively, if a small business believes that it has been prejudiced by bundling, it can protest a contract through the GAO. However, small businesses must be sure to follow the strict GAO procedural requirements. *See* 13 C.F.R.

D. Problems Not Limited to the Small Business Administration

The SBA is not the only agency at fault in this disorganized system of oversight. Representatives from the procuring agencies included in the OIG report acknowledged that they did not always notify the SBA of their bundlings.¹¹⁴ This lack of notification is largely attributable to the fact that agencies are unaware of the reporting requirements. In some cases, officials at these agencies did not realize that they were required to report all potential bundlings, regardless of whether a PCR was directly assigned to their agency.¹¹⁵ In other cases, officials believed that they were not required to report bundlings without a specific request from the SBA, or that they were not required to report at all.¹¹⁶ The unreported incidents of contract bundling can also partially be explained by the fact that procuring agencies do not always understand what constitutes bundling. In order to rectify these problems, the SBA needs to take a significant role in educating PCRs and federal agencies. Unfortunately, despite the recommendations of both the Office of Management and Budget (“OMB”)¹¹⁷ and the General Accounting Office (“GAO”),¹¹⁸ the SBA has not distributed a best practices guide that would help both procuring offices and the SBA itself develop more uniform and consistent reporting.¹¹⁹

The lack of proper training regarding contract bundling has created an environment in which the agencies have a low likelihood of reporting the vast majority of their bundled contract solicitations to the SBA. These findings are a strong indication that controlling contract bundling is a very low priority among federal agencies. While this is problematic in itself, the fact that there are not repercussions for failure to report bundled contracts is equally troubling. Without any penalties for failing to report, federal agencies will have little incentive to spend the time and money necessary to

§ 121.1001 *et seq.*; GENERAL ACCOUNTING OFFICE, GAO-03-539SP, BID PROTESTS AT GAO: A DESCRIPTIVE GUIDE (2003).

¹¹⁴ OFFICE OF INSPECTOR GENERAL, SMALL BUSINESS ADMIN., *supra* note 98, at 4.

¹¹⁵ *Id.* at 5.

¹¹⁶ *Id.* (“There is no requirement that I am aware of, for SBA to review agency’s proposed bundled solicitations.”).

¹¹⁷ See OFFICE OF MANAGEMENT AND BUDGET, CONTRACT BUNDLING: A STRATEGY FOR INCREASING FEDERAL CONTRACTING OPPORTUNITIES FOR SMALL BUSINESSES 10 (2002).

¹¹⁸ See GENERAL ACCOUNTING OFFICE, CONTRACT MANAGEMENT: IMPACT OF STRATEGY TO MITIGATE EFFECTS OF CONTRACT BUNDLING ON SMALL BUSINESS IS UNCERTAIN (2004).

¹¹⁹ In response to the OIG report, an SBA official claimed that a best practices guide was in the process of being finalized and was to be posted and distributed by June 12, 2005. See Letter from Allegra McCullough, Associate Deputy Administrator for Government Contracting and Business Development, U.S. Small Business Administration, to Robert G. Seabrooks, Assistant Inspector General for Auditing, U.S. Small Business Administration (May 12, 2005), available at <http://www.sba.gov/ig/05-20.pdf>. No such guide has been produced.

properly train their contracting personnel and controlling contract bundling will remain a low priority among federal agencies.

E. Recommended Actions

In order to counteract the effects of contract bundling and bring more certainty to its review process, the SBA must implement a number of measures, including some of those provided by the OIG report.¹²⁰ One of the keys to solving these problems will be developing standard procedures easily accessible within the SBA and to procuring agencies. The first step would be to produce the best practices guide, as recommended by the OMB and GAO, and distribute it to PCRs and agency employees responsible for contracting. This will help alleviate much of the confusion expressed by agency officials about their role in reporting bundled contracts. Accordingly, the SBA must ensure that its PCRs develop the current operating plans as required by its Standard Operating Procedures. Given the interrelatedness of these two measures, the creation of a best practices guide would certainly help to produce effective operating plans. These actions would play a significant role in providing better guidance to agencies and educating them about their role in the contract bundling review process. In addition, these guidelines would provide a tool for agency executives, which would allow for more effective training of their contracting employees.¹²¹

Additionally, the SBA must address the information systems problems that were revealed by the OIG report. One obvious way to correct this problem is for the SBA to comply with the requirement that it develop a database, as directed by the Small Business Reauthorization Act of 2000. Although, given the cost of developing such a system and the limited budget of the SBA, it is more likely that it will continue to rely on the FPDS-NG. Thus it will be important for the SBA to establish specific procedures for using the FPDS-NG as a system to report on bundling. Also, because the SBA will likely continue to rely on the FPDS-NG, it is even more important that it develops a reliable data tracking system to ensure that potential bundlings are in fact reviewed. Without a system to organize this information and produce efficient reviews, the SBA's reliance on the FPDS-NG for reporting purposes will be increasingly difficult and of little use.

Finally, as a matter of policy, the SBA, and perhaps Congress, need to address the fact that there are no repercussions for agencies if they fail to report potential bundlings. By holding agencies accountable for failures to

¹²⁰ OFFICE OF INSPECTOR GENERAL, SMALL BUSINESS ADMIN., *supra* note 98.

¹²¹ It would also be beneficial to allow agency procurement executives to consider an employee's success in identifying and reporting potential contract bundling as a factor in annual performance reviews, similar to the proposal in S.137. *Supra* note 72 and accompanying text.

report to the SBA, the overall number of bundled contracts reviewed should increase. It is also possible that agencies, to avoid having to go through the reporting process, will make a greater effort to avoid bundled contracts in general. Possible penalties could include administrative actions by the SBA (perhaps limiting the agency's ability to exercise options on unreported contracts that are revealed to be bundled) or tying failures to report to agency funding. These recommendations would also be more effective in light of the previously mentioned proposed regulatory and statutory changes.¹²²

¹²² *Supra* notes 65-67, 69-73, 75, and accompanying text.